Hope
Hope Credit Union
Hope Enterprise Corporation

April 8, 2013

Lisa M. Jones
Manager, CDFI Fund Bond Guarantee Program
CDFI Fund
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington DC 20220

Dear Ms. Jones,

Hope Enterprise Corporation (HOPE) is pleased to make these comments on the Interim Rule implementing the Guarantees for Bonds Issued for Community or Economic Development Purposes (CDFI Fund Bond Guarantee Program). HOPE is a community development financial institution, intermediary and policy center with a 19-year track record of strengthening communities, building assets and improving lives in economically distressed Mid South communities. Since 1994, HOPE's efforts have generated more than $1.7 billion in financing and benefited more than 130,000 individuals across the Mid South states of Arkansas, Louisiana, Mississippi and Tennessee.

The communities that HOPE serves are some of the most distressed in the country. Mississippi, Louisiana, and Arkansas, have the first, third and fourth highest poverty rates, respectively, in the country. The region also has significantly lower assets, and higher rates of unbanked and underbanked households, than the nation at large. When the CDFI Fund Bond Guarantee Program was included in the Small Business Act of 2010, we were excited about the potential impact it could have on our ability to serve distressed communities across our region. This program represents a major opportunity for the CDFI Fund to enhance the capacity of CDFIs and expand their abilities to provide financing in many of the nation's poorest and most financially underserved communities. We applaud the CDFI Fund staff for the work that they have put into developing the Interim Rules.

As the CDFI Fund finalizes the regulations for the CDFI Fund Bond Guarantee Program, we have the following recommendations:

1. Ensure that the Regulations Promote the Program Intent

As we understand it, the intent of the CDFI Fund Bond Guarantee Program is to assist CDFIs in expanding their current business in serving low-income and low-wealth communities, financing

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small businesses, community organizations, and low-income families. Section V(A)(4) of the Interim Rule says that the program "will allow Certified CDFIs to offer a higher volume of longer term products to their borrowers as well as manage their interest rate and duration risk because of improved asset/liability matching. This will further close the gap in the provision of investments in community facilities, business lending and financial services to rural and Low-Income residents and businesses, addressing distributional issues in the provision of financial services."

The Interim Rule indicates the expectation that the program will be used to expand the ability of CDFIs to serve their current customers including small businesses, community organizations, and low-income families. It states in Section V(A)(4)(b) that "if the $200 million to $2 billion range is used to estimate the minimum and maximum impact range for the CDFI Fund Bond Guarantee program, using the average loan size of $75,000 for CDFIs, a total of 2,667 to 26,670 loans may be issued. A share of these loans – potentially over half – will involve detailed and costly underwriting information at the household and firm level for loan recipients that otherwise would not receive funding."

We believe that the program, as structured by the Interim Rule, may not help CDFIs expand their current lines of business as intended. Instead, we believe it may lead to a completely new line of business, just as the New Markets Tax Credit program has done. The amortizing nature of the bond, the structure of the Relending Account, the structure of the Risk-Share Pool, and the transactional costs, particularly related to the Qualified Issuer, create significant burdens to CDFIs for asset and liability management, transaction management and partner risk. These factors will increase the likelihood that CDFIs that participate in this program will decide to make large Secondary Loans to minimize the number of them, thereby minimizing their transaction and compliance costs. This will diminish – or eliminate – the program's ability to meet the original intent, to make "investments in community facilities, business lending and financial services to rural and Low-Income residents and businesses, addressing distributional issues in the provision of financial services".

We are pleased that the Interim Rule provides for a period of 60 months after a guarantee is issued for Bond Loans to be made. We emphasize that this is an appropriate allowance. In other programs, the CDFI Fund has given additional weighting to those applications that "demonstrate" an ability to lend out funds more quickly. This is easier to do when the loans are of larger sizes. The CDFI Fund should be cognizant of this bias and be aware that to use the funds in small loans will likely take more time than in larger loans.

Our comments focus on ways that the Interim Rule can be altered to better enable the program to meet what we believe to be the initial program intent, given the underlying budget constraints. Changes to increase program clarity, increase flexibility and decrease transaction costs will increase the ability of CDFIs to use the program as initially intended.

2. Structure the Program for Long Term Success

Under the current budget requirements, it is our understanding that successful applications for Guarantees must be scored by the Office of Management and Budget (OMB) to require no subsidy. This is because the current federal budget does not include any funds for this program. Other federal guarantee programs do utilize federal funds as subsidy, so it is conceivable that at some point in the future there may be a federal appropriation for the CDFI Fund Bond Guarantee program. We recommend that the regulations be written to allow for this possibility, enabling the program to operate more effectively long-term.

Currently, the Interim Rule creates a rigid set of requirements based on the current zero subsidy budget. It requires the Bond Loan to have full recourse to the CDFI, be collateralized, and provides little flexibility in terms of credit criteria. We are recommending that the regulations outline the process that the CDFI Fund should use in evaluating applications for Guarantees, without setting rigid thresholds through these regulations. In the case that Congress does appropriate funds to the CDFI Fund Bond Guarantee Program in the future, this will ensure that the CDFI Fund does not have to issue new regulations, which takes significant time and resources.

In order for this program to evolve over time and to respond to changes in the Federal budget, the capital markets, policy priorities, and program needs, the CDFI Fund should not establish rigid credit requirements in the regulations, but instead specify in the regulations the credit criteria to be evaluated, including the types of collateral that may be allowed or instances when collateral may not be necessary. Each year, based on budget criteria, the CDFI Fund can then determine the credit threshold requirement for the program based on the approved Federal budget, and provide flexibility to the CDFIs and Qualified Issuers to propose credit and collateral structures in their applications for Guarantees. The regulations should outline the factors that must be evaluated but not include specific credit requirements.

Based on the process and criteria for consideration outlined in the regulations, the CDFI Fund could structure the application and award process in two common ways:

- Set clear application scoring criteria such as many other federal, state and local programs. One example is the Low Income Housing Tax Credit Program, which establishes funding priorities and detailed threshold and scoring criteria on a state by state basis every year; or
- Establish a process by which applicants work with the CDFI Fund to provide sufficient collateral in order to meet the credit and other requirements in order to receive a Guarantee. For example, Small Business Administration guarantees for lenders who are not considered “preferred lenders” are awarded based on a process in which lenders follow requirements, and may negotiate collateral and other loan requirements.

We believe that the credit requirements which are currently incorporated within the Interim Rule are more rigid than necessary and may unduly restrict the ability of both Treasury and Congress in implementing this program in future years. In appropriating funds specific to this program, Congress ultimately decides how much credit risk the CDFI Fund may take with regard to this program. Based on Congress's appropriation, the CDFI Fund can structure the credit requirements and award decisions accordingly. We suggest that it is not the role of the Interim Rule to dictate the credit risk or amount of subsidy which the program can allow.

3. Prioritize Mission and Demonstrated Commitment in Selecting Program Participants

We believe that one of the keys to facilitating the program's ability to meet its intended purpose is selecting entities to participate which have a strong mission and demonstrated commitment to implement the program with a focus on the program's goals. This includes the Qualified Issuer, Master Servicer and the CDFIs.

The CDFI Fund Bond Guarantee Program represents a very significant source of new funding for CDFIs. As is always the case, this will attract those seeking financial profit rather than those who are primarily focused on the mission of the CDFI Fund. Because of the current zero subsidy and tight credit requirements, it may be difficult for CDFIs to fully utilize the program. As the gatekeeper to CDFI certification and this program, we ask that the CDFI Fund not lower the standards for CDFIs in order to certify new CDFIs to use this program. Instead, we suggest that the cDFi Fund gives priority status to CDFIs who have a track record of lending to low-income, low-wealth, and underserved communities.

4. Take Steps to Minimize Program Cost

Bond pricing will make or break this program. We understand why the CDFI Fund has been reticent to release information regarding the ultimate pricing on the Bonds. However, we are concerned that there is still no clear pricing model. Because of that, it is impossible to evaluate how this program is going to work and if it is going to be feasible.

There are several measures that the CDFI Fund can take to ensure that the program fees remain as low as possible:

- The statute and the Interim Rule detail certain requirements for the Qualified Issuer. During the recent information sessions, we heard CDFI Fund staff intimate additional responsibilities to be placed on the Qualified Issuers in documents that have not yet been released (Bond Documents, Bond Loan Documents, Secondary Loan Documents, Servicing Requirements, etc.). We are concerned that as these responsibilities mount, so will the fees charged by Qualified Issuers. This will increase the cost of each loan and lead to fewer loans, increasing the likelihood that the program is only available to very large borrowers, and does not meet the initial intent of the program to serve small businesses and low-income communities. We ask that the CDFI Fund be cognizant of this and limit the responsibilities to only those absolutely necessary.

- As the CDFI Fund discovered with the New Markets Tax Credit program, much of the benefit of the program is distributed to consultants (attorneys, accountants, etc.) in the form of transaction fees. Some of these are necessary, but many have been egregious. Required reporting has reduced the incidence of this. Thus, we suggest that the CDFI Fund establish systems whereby every party compensated directly or indirectly as part of this program must report their compensation.

- Provide clear and regular program guidance. Program ambiguity increases program costs because it increases the need for attorneys and other professionals to provide clarity regarding unanswered questions. The CDFI Fund can reduce the fees that will be charged by providing ongoing, timely, and definitive guidance as questions arise and when clarification is needed.

5. Revise the Requirements for Collateral Based on OMB Circular A-129

Section 1808.101(e)(1) requires that each Bond Loan be a general recourse obligation of the Eligible CDFI and secured by a first lien on the collateral, and that each secondary loan be secured by a first lien on the collateral. We understand that under current budget constraints and with the requirement of a zero budget line-item for this program, the federal government cannot take any significant risk when making a Guarantee. However, by including these collateral and recourse requirements in the Interim Rule, it unnecessarily restricts the future flexibility of the program.

In discussions with CDFI Fund staff, it is our understanding that many of the requirements of the Interim Rule, and in particular, this requirement regarding collateral, are derived from OMB Circular A-129. However, A-129 does not require collateral, but only states that "the Government can reduce its risk of default and potential losses through well managed collateral requirements". Should budget priorities change, it would not be ideal that the Rule require collateral if future appropriations no longer require a zero-interest budget line item for this program.

The requirements for full recourse and collateral are also problematic for the CDFI industry because most CDFIs have debt obligations with prohibitions against incurring additional debt that is both general recourse and collateralized. In order for most CDFIs to use the program as required in the Interim Rule, they will have to do one of two things:

- Pay off existing debt and capitalize their balance sheet with the proceeds of the Bond Loan. The problems with this are many. Are CDFIs prepared to pay off their many creditors for a one-time source of capital that has an uncertain future? Will these creditors once paid-off return as lenders to this CDFI if or when needed? Does this really achieve the intent of the program of expanding the availability of capital to CDFIs or just replace existing capital?

- Alternatively, CDFIs may create new CDFIs for the purpose of utilizing this program. This will create a challenge for the CDFI Fund to expeditiously certify these new CDFIs, and to determine how to underwrite applications for Guarantees related to these new CDFIs given the lack of track record and need to meet the statutory timelines.

Given these challenges, and the requirements in OMB Circular A-129, it is our recommendation that Section 1808.101(e)(1) allow for, but not require, collateral on a Bond Loan or a Secondary Loan, and that the collateral requirements be based on the credit criteria of the Program as implemented by the CDFI Fund.

6. Clarify that the Subordination Restrictions Only Apply to Tax Exempt Liabilities

The language regarding subordination of the Bond Loans to other debt should be clarified. Section 1808.302(d) of the Interim Rule requires that "the Bonds or Bond Loans may not be subordinated to any new or existing liability and effective subordination of the Bonds or Bond Loans to tax-exempt obligations will render the Guarantee void…" This section is based on an interpretation of OMB Circular No. A-129, and we believe that it is being interpreted too conservatively.

Citing the Federal Credit Reform Act of 1990, Section 661[1], A-129, Section II(B)(5)(b) states that "effective subordination of a direct or guaranteed loan to tax-exempt obligations will render the guarantee void." However, Section 1808.302(d) of the Interim Rule reads that the Bonds or Bond Loans may not be subordinated to <u>any</u> new or existing liabilities. This is a very important distinction. This section of A-129 clearly prohibits subordination of Federal Government loans to tax-exempt debt, but it does not include the same prohibition against other obligations.

A-129, Section II(C)(3)(b) also addresses subordination of Federal obligations. However, this section is not a strict prohibition but guidance for sound financial practices for the design of credit programs. This section states "The Government's claims should not be subordinated to the claims of other creditors, as in the case of a borrower default on either a direct loan or a guaranteed loan." This language, which is based on the Federal Credit Reform Act of 1990, is intended to assist federal agencies in managing credit programs. Subordination of debt is an important consideration, but not a requirement to be included in the regulations. We believe that debt subordination should be included as a consideration in the application and awards process rather than a rigid program requirement.

Section 1808.302(d) of the Interim Rule should be clarified to stipulate that the subordination restrictions only apply to tax exempt liabilities. The CDFI Fund can include additional

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[1] The Federal Credit Reform Act reads as follows: "The purposes of this subchapter are to –

(1) measure more accurately the costs of Federal credit programs;
(**2**) place the cost of credit programs on a budgetary basis equivalent to other Federal spending;
(3) encourage the delivery of benefits in the form most appropriate to the needs of beneficiaries; and
(4) improve the allocation of resources among credit programs and between credit and other spending programs."

restrictions in program guidelines or selection criteria, but it is unnecessary and not required for the program regulations to prohibit the Bond Loans to be subordinated to any new or existing liability.

7. Structure the Risk-Share Pool so that each CDFI's Risk-Share Stands Alone

In the case of multiple CDFIs participating in a Bond guarantee, Section 1808.303(c) of the Interim Rule requires that if a CDFI defaults, the defaulting CDFI's portion of the Risk-Share Pool be applied first for debt service, but "after depletion of the defaulted Eligible CDFI's deposit, each remaining Eligible CDFI's deposit shall be applied prorata to any such payment of debt service." We understand why the CDFI Fund has chosen to structure the Risk-Share Pool this way. As the CDFIs are participating together in a single bond there should be some kind of joint responsibility.

We would however, suggest that the CDFI Fund consider the possible unintended consequences of this position. There is no mechanism in this structure, other than scolding, for the other CDFIs to improve the performance of the defaulting CDFI. This structure creates not only the need for trust among peers, but also the possibility of severe distrust and rush to judgment. A CDFI that defaults first uses its Risk-Share Pool and then uses the other CDFI's Risk-Share Pools. In order for the other CDFIs to not lose the "value" of the Risk-Share Pools that they contributed, they may rush to default, exacerbating, rather than containing a default situation. We recommend that the Risk-Share Pool should be structured so that each CDFI's Risk-Share Pool stands alone.

8. Allow CDFIs to Capitalize the Risk-Share Pool with Bond Proceeds

Section 4713a(d) of the statute states that "each qualified issuer shall, during the term of a guarantee provided under the Program, establish a risk-share pool, capitalized by contributions from eligible community development financial institution participants an amount equal to 3 percent of the guaranteed amount outstanding on the subject notes and bonds". This language does not prohibit CDFIs from utilizing bond proceeds to fund the risk-share pool. Indeed Section (c)(3) states that "the proceeds of the guaranteed bonds or notes under the Program may not be used to pay fees (other than costs of issuance fees), and shall be held in- (A) community or economic development loans; (B) a relending account, to the extent authorized under paragraph (2); or (C) a risk-share pool established under sub-section (d)." This appears to be in direct conflict with section 1808.303(a) of the Interim Rule that states that "at each disbursement of the Bond Loan proceeds, each Eligible CDFI shall deposit an amount that is equal to three percent of the disbursement… from monies other than Bond Loan proceeds". We recommend revising the regulation to allow CDFIs to utilize Bond Loan proceeds to capitalize the Risk-Share Pool as contemplated by the statute.

9. Ensure that the Relending Account Applies Only to Bond Loans

The Interim Rule requires the Secondary Loan repayments be placed into the Relending Account, managed by the Master Servicer. Although seemingly innocuous, this will undoubtedly become burdensome when making additional Secondary Loans and will likely result in CDFIs minimizing the number of Secondary Loans that they make in order to minimize the number of transactions with the Relending Account. Once again, this discourages CDFIs from fulfilling the intent of the statute.

Our interpretation of this section of the statute is that the Relending Account should not apply to Secondary Loans, but only to Bond Loans made by the Qualified Issuer to the CDFIs. The statute states in 4713a(c)(2) that funds held in the Relending Account "may be made available for new eligible community or economic development purposes." The statute defines "eligible community or economic development purpose" as "any purpose described in section 4707(b) of this title[2]; and includes the provision of community or economic development in low-income or underserved rural areas."

The statute repeatedly uses the phrase "eligible community or economic development purposes" referencing Bond Loans from the Qualified Issuer to the CDFI:

- Definition of Program (Section 4713a(a)(6)): "The guarantee Program for bonds and notes issued for *eligible community or economic development purposes* established under this section."
- Definition of Loan (Section 4317a(a)(4)): "Any credit instrument that is extended under the Program for any *eligible community or economic development purpose*."
- Definition of Qualified Issuer (Section 4713a(a)(8)(B)(ii)): "A qualified issuer shall have the appropriate expertise, capacity, and experience, or otherwise be qualified to make loans for *eligible community or economic development purposes*… and certify to the

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[2] Section 4707(b) reads: "Financial assistance made available under this subchapter may be used by assisted community development financial institutions to serve investment areas or targeted populations by developing or supporting—
(A) commercial facilities that promote revitalization, community stability, or job creation or retention;
(B) businesses that—
(i) provide jobs for low-income people or are owned by low-income people; or
(ii) enhance the availability of products and services to low-income people;
(C) community facilities;
(D) the provision of basic financial services;
(E) housing that is principally affordable to low-income people, except that assistance used to facilitate homeownership shall only be used for services and lending products—
(i) that serve low-income people; and
(ii) that—
(I) are not provided by other lenders in the area; or
(II) complement the services and lending products provided by other lenders that serve the investment area or targeted population; and
(F) other businesses and activities deemed appropriate by the Fund."

Secretary that the bonds or notes to be guaranteed are to be used for eligible community or economic development purposes."

- Guarantees authorized (Section 4713a(b)): "The Secretary shall guarantee payments on bonds or notes issued by any qualified issuer, if the proceeds of the bonds or notes are used in accordance with this section to make loans to eligible community development financial institutions (1) for *eligible community or economic development purposes*…"

Thus, the statute requires that the Relending Account is an account in which the Qualified Issuer deposits repayments of the Bond Loan in excess of payments required back to the Federal Financing Bank (FFB) from the Qualified Issuer. However, the Interim Rule applies this structure of the Relending Account described in the statute to Secondary Loans rather than just to Bond Loans. We believe this is an overly strict interpretation. If CDFIs are able to keep the repayments of Secondary Loans to continue to recycle for eligible uses without managing payments to and from the Relending Account managed by the Master Servicer, it will significantly increase the program flexibility, decrease program cost, and improve their ability to meet the intent of the program.

10. Clarify that the Risk-Share Pool Does Not Reduce the 10% of the Relending Account

The language in the statute regarding the calculation of the relending account is unclear. The CDFI Fund has chosen to interpret the language to require that the risk-share pool reduce what is available in the relending account. We encourage the CDFI Fund to reconsider this interpretation because other interpretations are equally valid and the way that it has been interpreted in the Interim Rule unduly restricts the program. It decreases the amount of funds available in the Relending Account, which makes it more difficult to make smaller loans and loans for shorter terms.

Section 4713a(c)(2) of the statute says that "not more than 10 percent of the principal amount of guaranteed bonds or notes, multiplied by an amount equal to the outstanding principal balance of issued notes or bonds, minus the risk-share pool amount under sub-section (d), may be held in a relending account and may be made available for new eligible community or economic development purposes." There are many possible readings of this language. If calculated as described here, the relending account for a $100 million bond with an outstanding balance of $50 million would be capped at $499,999,998,500,000, as calculated below:

10% x $100,000,000 x $50,000,000 - $1,500,000 = $499,999,998,500,000

This is probably not the intent, but literally, this is the correct calculation.

We assume that instead of "an amount equal to the outstanding principal", that the statute could be stretched to be interpreted as "the percentage of the issued notes or bonds that are outstanding". With this assumption, there are still multiple possible readings of the statute:

- (10% of the principal amount of guaranteed bonds) x (the outstanding principal balance of issued notes or bonds) – (the risk share pool amount)

- (10% of the principal amount of guaranteed bonds) x (the outstanding principal balance of issued notes or bonds – the risk share pool amount)
- 10% of (the principal amount of guaranteed bonds x the outstanding principal balance of issued notes or bonds – the risk share pool amount)

Given the lack of clarity and the need to interpret the statutory language, we argue that the language should be interpreted with the goals and intent of the program in mind. We recommend the following interpretation: 10% of the total of the following: the principal amount of guaranteed bonds TIMES the percentage of the issued notes or bonds that are outstanding MINUS the risk share pool amount. Given the example above, this would result in a Risk Share Pool of:

10% x ($100,000,000 x 50% - $1,500,000) = $4,850,000

This interpretation provides the maximum benefit to the program because it maximizes the amount allowed to be held in the relending account at any one time. This is important because it can ease the ability to implement the program in the most cost effective manner.

11. Allow for Flexible Terms of Bond Maturity

The amortizing nature of these funds limits the eligible uses of funds and encourages the use of the funds for fewer large loans, thus further decreasing the likelihood that the funds will be used for small business loans. We understand that one of the reasons for amortizing these bonds is to mitigate risk and to ensure that the full amount of the bonds is not outstanding for the full bond period of up to 30 years. However, by structuring the bonds as amortizing, it limits the ability of the funds to revolve and therefore restricts the flexibility of the program.

An amortizing bond is not required by the statute or by Federal Financing Bank policies. The loan guidelines of the Federal Financing Bank state that "The Bank provides a lending rate for any amount required and for any maturity." An amortizing bond essentially sets up these funds as a one-time source of funding and not a source of capital for the ongoing business of the CDFI. This does not achieve the intent of the statue. We suggest that the Interim Rule remain silent on the structure of the Bond, allowing for both amortizing and bulleted (or serialized) debt in order to increase the flexibility and impact of the program.

12. Remove the Pricing Collar from the Regulations

Pricing will determine what are the feasible uses of the funds. The Interim Rule places minimum and maximum limits on the Secondary Loan pricing. Section 1808.307(c)(1) states: "With respect to each Secondary Loan, the Eligible CDFI will be required to propose to the CDFI Fund: (i) A minimum and maximum spread over the corresponding Bond Loan Rate". We believe that the rate pricing should not be included in the regulations for several reasons. First, pricing is not mentioned in the statute, and is therefore not required to be included in the regulations. Secondly, negotiating the rate with the CDFI Fund on each loan separately will be onerous, and will increase the time and cost associated with making each loan. This will create an incentive for CDFIs to make fewer loans, which will prevent the program from meeting its intended purpose of making small business and other typical CDFI loans. Thirdly, throughout the Interim Rule, the CDFI Fund works solely with the Qualified Issuers, who work with the CDFIs. However, in this section the CDFI is required to propose rates directly to the CDFI Fund. This is inconsistent with the rest of the proposed regulations. And lastly, the CDFI Fund should not be in the business of setting loan spreads. Instead it should focus on selecting qualified, experienced, and mission focused CDFIs to receive the Bond Loans and lend the funds for eligible Secondary Loans.

Thank you for the opportunity to comment on the Interim Rule for this very important program. In his State of the Union address, President Obama issued a clarion call for the nation to act boldly to build ladders that enable Americans to climb out of poverty. As a CDFI serving one of our nation's most impoverished regions, we have significant experience working towards this goal. We believe that if the Interim Rule is altered to ensure CDFIs can use it for its original intent, this program has significant potential to impact impoverished communities, and can contribute to the Administration's goal to help families to climb out of poverty.

Again, thank you for your consideration of our comments. We would be happy to elaborate further should the CDFI Fund have questions regarding any of our comments.

Sincerely,

William J. Bynum

William J. Bynum
Chief Executive Officer